

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re: HANCOCK FABRICS, INC., <i>et al.</i> ¹ Debtors.	Chapter 11 Case No. 16-10296 (BLS) Jointly Administered Re: Dkt. Nos. 1486, 1493, 1575
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**OBJECTION OF PENSION BENEFIT GUARANTY CORPORATION TO THE
DISCLOSURE STATEMENT FOR DEBTORS' FIRST AMENDED
JOINT CHAPTER 11 PLAN OF LIQUIDATION**

Pension Benefit Guaranty Corporation (“PBGC”) hereby objects to the relief sought in the Motion of Debtors and Debtors in Possession for an Order (A) Approving Proposed Disclosure Statement for Debtors’ First Amended Joint Chapter 11 Plan of Liquidation, Dated as of March 8, 2017; (B) Establishing Procedures for Solicitation and Tabulation of Votes to Accept or Reject Proposed Joint Chapter 11 Plan of Liquidation and (C) Scheduling a Hearing on Confirmation of Proposed Joint Chapter 11 Plan of Liquidating and Approving Related Notice Procedures [Dkt. No. 1493] (“Motion”), and to the approval of the Disclosure Statement for Debtors’ First Amended Joint Chapter 11 Plan of Liquidation [Dkt. No. 1486] (“Disclosure Statement”) and joins in the Objection of the Official Committee of Unsecured Creditors to the Debtors’ Plan and to Approval of the Disclosure Statement [Dkt. No. 1575] (“Committee Objection”). PBGC is a creditor in these cases with claims of approximately \$74 million relating to the Hancock Fabrics, Inc. Consolidated Retirement Plan (“Pension Plan”). In support of this

¹ The Debtors in these cases, along with the last four digits of each Debtor’s federal tax identification number, are Hancock Fabrics, Inc. (0905), Hancock Fabrics, LLC (9837), Hancock Fabrics of MI, Inc. (5878), hancockfabrics.com, Inc. (9698), HF Enterprises, Inc. (7249), HF Merchandising, Inc. (8522) and HF Resources, Inc. (9563). The Debtors’ mailing address is P.O. Box 4440, Tupelo, MS 38803.

objection (“Objection”), PBGC respectfully represents as set forth below. In addition to the bases set forth in the Committee Objection, PBGC objects to the Disclosure Statement because it fails to provide “adequate information” as defined in 11 U.S.C. § 1125(a), with regard to the basis for substantive consolidation of the Debtors’ estates and the impact of substantive consolidation on the pension claims.

BACKGROUND

I. PBGC and TITLE IV of ERISA

1. PBGC is the wholly owned United States government corporation that administers the pension insurance program under Title IV of the Employee Retirement Income Security Act of 1974 (“ERISA”)² and protects participants in private sector defined benefit pension plans.³ PBGC guarantees the pension benefits up to the statutory limits of PBGC’s guarantee of nearly 40 million participants in approximately 24,000 pension plans, and is the statutory trustee of more than 4,800 failed pension plans.⁴ PBGC provides a backstop for American workers, securing retirement income for more than 1.5 million retirees.⁵

2. Under ERISA, an employer must contribute to its pension plan to fund the pension benefits promised to its workers. The contributing sponsor and each member of its “controlled group” are jointly and severally liable for (1) paying the statutorily required

² 29 U.S.C. §§ 1301-1461 (2012 & Supp. II 2014).

³ *PBGC v. LTV Corp.*, 496 U.S. 633, 636-39 (1990).

⁴ 2016 PBGC Annual Report at 2, <https://www.pbgc.gov/Documents/2016-Annual-Report.pdf>.

⁵ *Id.*

minimum funding contributions;⁶ (2) paying insurance premiums to PBGC;⁷ and, if the plan terminates, paying (3) any unfunded benefit liabilities to PBGC,⁸ and (4) termination premiums.⁹

3. When PBGC becomes the statutory trustee of a terminated pension plan, it has authority to collect all amounts for which the plan sponsor and controlled group members are jointly and severally liable.

II. PBGC-covered Pension Plan Sponsored by the Debtors

4. Hancock Fabrics, Inc., (“Hancock”) was the contributing sponsor of the Pension Plan, a single-employer defined benefit pension plan covered by Title IV of ERISA.¹⁰ Each Debtor is a member of Hancock’s controlled group, within the meaning of Title IV of ERISA.¹¹ The Pension Plan covers approximately 4,149 participants.

5. On May 10, 2016, PBGC issued a Notice of Determination to the Debtors under 29 U.S.C. §§ 1342(a)(2) and 1342(c) stating that the Pension Plan will be unable to pay benefits when due and that the Pension Plan must be terminated to protect the interests of the participants.

6. On May 10, 2016, PBGC also sent the Debtors an agreement to terminate the Pension Plan (“Trusteeship Agreement”). Hancock signed the Trusteeship Agreement on November 2, 2016, which terminated the Pension Plan, effective March 31, 2016. Hancock sent the Trusteeship Agreement to PBGC via overnight mail on November 14, and PBGC signed it on November 15, 2016. Consequently, it is PBGC to whom the Debtors’ employees and their

⁶ IRC §§ 412(b)(1) & (2); *see also* 29 U.S.C. §§ 1082(b)(1) & (2).

⁷ 29 U.S.C. § 1307.

⁸ 29 U.S.C. § 1362.

⁹ 29 U.S.C. § 1306(a)(7).

¹⁰ *See* 29 U.S.C. § 1321.

¹¹ *See* 29 U.S.C. § 1301(a)(13).

beneficiaries look for payment of their pension benefits under the Pension Plan, subject to ERISA's statutory limits.

III. The Debtors' Bankruptcy Proceeding

7. On February 2, 2016, each of the Debtors filed Chapter 11 petitions with this Court. On February 3, 2016, the Court ordered Joint Administration of the Debtors' cases for procedural purposes. PBGC was subsequently appointed to, and continues to serve on, the Official Committee of Unsecured Creditors.

8. As set forth more fully in the Disclosure Statement, immediately following the petition date, the Debtors commenced store closing sales at the Initial Closing Stores.¹² On March 31, 2016, the Court approved the sale of Debtors' inventory at the Remaining Closing Stores to Great American. On July 28, 2016, the Court approved the sale of the Debtors' Real Property. On July 28, 2016, the Court approved the sale of the Debtors' IP Assets to ADMACO. The Debtors have therefore liquidated all substantial estate assets.

9. On July 5, 2016, PBGC filed three claims against each of the seven Debtors, all of which are jointly and severally liable to the Pension Plan and PBGC under 26 U.S.C. § 412; 29 U.S.C. §§ 1082, 1306, 1307, 1362 ("PBGC Claims").¹³ The PBGC Claims consist of the following: (1) unfunded benefit liabilities in the amount of \$57,900,000; (2) unpaid minimum funding contributions in the amount of \$1,241,550, a portion of which is entitled to priority; and (3) termination premiums in the approximate amount of \$15,558,750.

¹² Capitalized terms used, but not defined herein, have the meanings ascribed to them in the Disclosure Statement.

¹³ See Claim Nos. 954-964; 1001-1010. On April 12, 2017, PBGC sent amended claims and statements in support to KCC for Claim Nos. 955, 957, 958, 960, 961, 962, 963, 964, 1002, 1004, 1005, 1007, 1008, and 1010.

10. On March 8, 2017, the Debtors filed the Disclosure Statement and the Debtors' First Amended Joint Chapter 11 Plan of Liquidation ("Plan") ([ECF No. 1485]). The Plan calls for substantive consolidation of the Debtors' estates.¹⁴

11. On December 28, 2016, PBGC requested a waterfall analysis from the Debtors to quantify the expected financial impact of substantive consolidation on the PBGC Claims. On February 10, 2017, PBGC instead received a one-page summary of the assets by Debtor entity as of the filing date.

12. In response to PBGC's request for more information regarding the liabilities of each Debtor entity, on April 5, 2017, counsel for the Debtors provided PBGC a one-page summary of the liabilities by Debtor entity as of the filing date.

13. PBGC is analyzing the limited information provided by Debtors, coupled with the March operating report filed this week and information provided by the Committee to PBGC in its capacity as a creditor, to assess the effect of substantive consolidation. However, PBGC is likely to have additional factual questions about the assets and liabilities of the estate on a current and going-forward basis.

JOINDER

14. For the reasons set forth in the Committee Objection, PBGC objects to the Disclosure Statement.

¹⁴ Plan, Art. 6(A).

ADDITIONAL OBJECTION

I. The Disclosure Statement fails to provide adequate information regarding the proposed substantive consolidation.

15. PBGC objects to the Disclosure Statement because it fails to inform creditors of facts that may affect the value of their claims and the confirmability of the Plan. Under the Bankruptcy Code, a disclosure statement contains “adequate information” if it provides:

information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor . . . that would enable such a hypothetical investor . . . to make an informed judgment about the plan. . . .¹⁵

16. The Disclosure Statement does not meet this threshold because it fails to provide sufficient information to creditors regarding the grounds for the proposed substantive consolidation of the individual estates and the effect of substantive consolidation on claims.

17. Article IV, Section C(7) of the Disclosure Statement states:

Notwithstanding the occurrence of the Effective Date and regardless of whether the Debtors are substantively consolidated as part of the Plan, the Chapter 11 Cases of any Debtor entities may be dismissed by order of the Bankruptcy Court and each such entity may be excluded from the Plan. To the extent that the Debtors may be substantively consolidated as part of the Plan, the cases related to certain Estates may be closed prior to completion of distributions.¹⁶

However, the Disclosure Statement fails to mention anything further about substantive consolidation. At a minimum, the Disclosure Statement must (i) set forth the Debtors’ estimate of the effect of substantive consolidation on the PBGC Claims and on the claims of any other

¹⁵ 11 U.S.C. § 1125(a)(1); *see also In re PWS Holding Corp.*, 228 F.3d 224, 248 (3d Cir. 2000); *Krystal Cadillac-Oldsmobile GMC Truck, Inc. v. General Motors Corp.*, 337 F.3d 314, 322 (3d Cir. 2003) (“The importance of full disclosure is underlaid by the reliance placed upon the disclosure statement by the creditors and the court. Given this reliance, we cannot overemphasize the debtor’s obligation to provide sufficient data to satisfy the Code standard of adequate protection.”) (quoting *Oneida Motor Freight, Inc. v. United Jersey Bank*, 848 F.2d 414, 417 (3d Cir. 1988) (internal quotes omitted)).

¹⁶ Disclosure Statement, Art. IV(C)(7).

creditors; (ii) provide the rationale for why substantive consolidation is being sought; and (iii) detail the risks of seeking substantive consolidation.¹⁷ This information is necessary for creditors to make an informed decision about whether to accept or reject the Plan.

18. The Third Circuit considers substantive consolidation an “extraordinary” and “last-resort remedy.”¹⁸ In *Owens Corning*, the Third Circuit sets forth that substantive consolidation:

treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor. Consolidation restructures (and thus revalues) rights of creditors and *for certain creditors this may result in significantly less recovery.*¹⁹

The Disclosure Statement must explain that the courts permit substantive consolidation only in extraordinary situations and as a last-resort remedy.

19. The Disclosure Statement fails to provide any information on the effect of denying PBGC a separate recovery against each of the Debtors. “Adequate information”

¹⁷ See *In re Monroe Well Serv., Inc.*, 80 B.R. 324, 332 n.7 (Bankr. E.D. Pa. 1987) (“Because substantive consolidation is sought, the objectors are correct in seeking additional information about inter debtor accounts receivables. The statement should be amended to include this information.”); See also *In re Sea Trail Corp.*, No. 11-07370-8-SWH, 2012 WL 5247175 at *5 (Bankr. E.D.N.C. October 23, 2012) (“Courts have also acknowledged the underlying purpose of a disclosure statement, which is to provide creditors with enough information to determine what distribution or other assets they will receive and also what risks they will face.”) (internal quotation marks omitted); *In re Radco Props., Inc.*, 402 B.R. 666, 683 (Bankr. E.D.N.C. 2009) (A “disclosure statement should provide the average unsecured creditor what it is going to get, when it is going to get it, and what contingencies there are to getting its distribution.”) (internal quotation marks omitted).

¹⁸ *In re Owens Corning*, 419 F.3d 195, 199-200 (3d Cir. 2007).

¹⁹ *Id.* at 205 (internal quotes omitted) (emphasis added).

requires the Debtors to quantify the impact of substantive consolidation.²⁰ At the same time, PBGC believes that other creditors will benefit from substantive consolidation, by virtue of being able to recover from the combined estates. The Disclosure Statement should set forth the extent to which substantive consolidation will enhance other creditors' recovery, at the expense of PBGC. It should discuss the effect, if any, on other significant creditors.

20. The Disclosure Statement must also explain in plain terms the reason for seeking substantive consolidation. As this Court is well aware, the entities have the burden of proving that: (i) prepetition they disregarded separateness so significantly that their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.²¹ Neither of these appear to be true, and no rationale was given in the Disclosure Statement for substantive consolidation. This is not "adequate information."

21. The Debtors also should warn creditors about the possibility that substantive consolidation will not be permitted here, if this Court were to hold that the *Owens Corning* standards are not satisfied. The Disclosure Statement should be amended to include substantive consolidation among the enumerated risk factors to be considered regarding the Plan and its implementation.

22. In determining whether a disclosure statement contains adequate information, the court must consider "the complexity of the case, the benefit of additional information to

²⁰ See *Monroe*, 80 B.R. at 330 (holding that a disclosure statement must provide sufficient financial information "so that a creditor . . . can make an 'informed judgment' whether to accept or reject the plan.").

²¹ *Owens Corning*, 419 F.3d at 211.

creditors . . . and the cost of providing additional information.”²² Disclosure of additional information on the purpose, effect, and risks of substantive consolidation would materially benefit all creditors in making an informed decision about whether to accept or reject the Plan. Without the information, they lack the ability to make an informed decision. There is no reason to believe that that information would be costly for the Debtors.

23. PBGC does not ask the Court to decide at this time whether substantive consolidation as proposed by the Debtors is permissible under the Bankruptcy Code. That is an issue for another day. Rather, PBGC asks that the Debtors be required to amend their Disclosure Statement: (i) to inform creditors that the Plan provides for substantive consolidation of the Debtors’ estates; (ii) to quantify the financial effect it will have on PBGC and other affected creditors; (iii) to articulate their rationale for requesting substantive consolidation; and (iv) to describe in plain terms the downsides of proceeding with a Plan so predicated, given the risk it cannot be confirmed.

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²² 11 U.S.C. § 1125(a)(1).

CONCLUSION

Based on the foregoing, PBGC requests that the Court require the Debtors to further amend the Disclosure Statement to provide adequate information as required by 11 U.S.C.

§ 1125.

Dated: Washington, D.C.
April 14, 2017

Respectfully Submitted,

/s/ Kimberly E. Neureiter

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CERTIFICATE OF SERVICE

I hereby certify, that on this 14th day of April, 2017, the Objection of Pension Benefit Guaranty Corporation to the Disclosure Statement for Debtors' First Amended Joint Chapter 11 Plan of Liquidation was served on the following:

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/s/ Kimberly E. Neureiter
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